

## Internal Revenue Service

Number: **200241023**  
Release Date: 10/11/2002  
Index Number: 1362.02-03

## Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

**CC:PSI:3 PLR-116758-02**

Date:

**July 3, 2002**

Company:

Properties:

Facilities:

Corporation:

State:

PLR-116758-02

PLR-116758-02

a:

b:

c:

d:

e:

f:

g:

Dear \_\_\_\_\_ :

This letter responds to your letter dated March 13, 2002, as well as subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income received by Company from the Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

#### FACTS

Company was incorporated under the laws of State in a and elected under § 1362(a) to be an S corporation effective b. Company has accumulated earnings and profits.

Company owns, leases, and manages commercial real estate (the Properties) on which tenants run the Facilities. Until c, the tenants held the Properties under net leases. Company has restructured these contracts so that they are no longer net leases, effective b.

Corporation provides bookkeeping and general management services to the tenants regarding the operation of the Facilities.

In its real estate leasing and management business, Company employs d persons part-time (in addition to its president and sole shareholder) and engages the services of various independent contractors. Under the terms of its restructured leases, Company is responsible for the general upkeep of the Properties, which includes, without limitation, the maintenance and repair of roofs, interior and exterior walls,

PLR-116758-02

foundations, windows, signage, exterior lighting, parking areas, fencing, and out buildings. Company is responsible for painting (building interiors and exteriors); system maintenance and repair (plumbing, electrical, heating, and air conditioning); snow and ice removal; pest control; and the supervision of any tenant renovations. Company also handles the usual leasing and administrative functions involved in managing real estate.

Company received or accrued approximately e in rents and paid or incurred approximately f in relevant expenses for g on the Properties. The rental income and expense figures under the restructured leases are expected to be at least as high.

### LAW AND ANALYSIS

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) terminates whenever the corporation (I) has accumulated earnings and profits at the close of each of three consecutive tax years, and (II) has gross receipts for each of such tax years more than 25 percent of which are passive investment income.

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(ii)(B)(1) of the Income Tax Regulations provides that "rents" means amounts received for the use of, or the right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that "rents" does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

PLR-116758-02

## CONCLUSION

Based on the facts submitted and representations made, we conclude that the rents Company receives from the Properties are not passive investment income under § 1362(d)(3)(C)(i).

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's eligibility to elect to be treated as an S corporation. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

Under a power of attorney on file with this office, we are sending the original of this letter to you and a copy to Company.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/

MARY BETH COLLINS  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure: copy for § 6110 purposes

cc: